Strix Group PLC

An opportunistic and strategic acquisition

7 October 2022

Strix's announcement of their conditional purchase of Billi is another example of the management's ability to identify acquisitions that are both good value and make excellent strategic sense. The group has been eyeing the multifunctional tap market for some time. Not only does the merger widen the group's product portfolio, but it additionally brings in new markets – not least into commercial offices. We also expect the strong cash flow from Billi to result in a rapid deleveraging of the Group. We note the Directors' subscription in the placing, amounting to £0.37m.

Significantly, the merger presents an opportunity for targets in the Group's five-year plan to be met a year early, but for now we conservatively hold our financial estimates and Fair Value per share, with the latter now at a significant premium to the current price.

- Strix has announced the acquisition of Billi, a manufacturer and distributor of multifunctional taps. The purchase is conditional on approvals from the UK, Australian and New Zealand competition authorities, with completion anticipated by the end of January '23 at the latest. The acquisition was opportunistic with Strix taking swift action when Billi became available. Billi's inclusion in the Culligan / Waterlogic merger was potentially considered against the public interest.

- The consideration of £38m on a cash free basis will be funded by the proceeds of a share placing, raising £13m gross, and additional bank lending, including a refinancing of the Group's facilities. Based on projections for proforma revenues and EBITDA to December 2022, we think the acquisition represents excellent value at 0.87x projected and 3.725x, respectively. We believe the highly attractive purchase price largely reflects Strix's ability to move very quickly on the deal, helping the Culligan/Waterlogic merger to progress.

- Multifunctional taps were an opportunity in the Group's product portfolio. LAICA continues to widen portfolio of countertop appliances, but Billi taps moves the range under the counter for the first time. The acquisition provides an entry into commercial markets, having previously focused on consumers. As with LAICA, Billi's products require consumables (filters and CO2 canisters), although servicing revenues highlight a greater emphasis on added value margins.

- Billi further strengthens the ESG positioning of the Group, as its taps are energy efficient (via use of a heat exchanger), and the product also lowers the use of single plastic bottles.

- Historically, Billi's revenues have improved by low double digit CAGR % over the last five years, aided by a recent move into the residential market. We expect further organic growth to be derived from a combination of a cross-fertilisation of sales to the enlarged customer base, new product launches, and entry into international markets via existing distributor/retailer relationships.

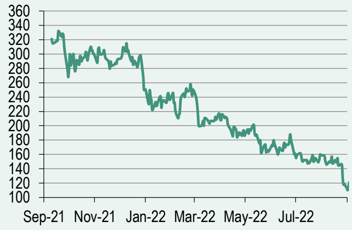
- Combined with the improving outlook for revenues, we expect Strix margins to progress reflecting synergy benefits as Billi is integrated into the group. Efficiency gains from the introduction of greater automation within the Australian manufacturing base and the sourcing of some components internally, with procurement increasingly integrated. In addition, we believe there is scope for savings in marketing costs.

In this note we cover the positive implications of the acquisition for Strix, although we leave estimates unchanged at this early stage. We expect to update forecasts following completion, which is anticipated in approximately three months ([previous numbers can be found in our last note here](#)). On this basis we have also retained our Fair Value / share at 236p, of twice the current price after recent declines.

Company Data

EPIC	KETL
Price (last close)	118p
52 weeks Hi/Lo	348p/110
Market cap	£258.9m
ED Fair Value / share	236p
Net debt (Jun '22)	£61.3m

Share Price, p



Source: ADVFN

Description

Strix Group PLC ("Strix") is a global leader in the design, manufacture and supply of kettle safety controls and other components and devices involving water heating and temperature control, steam management, and water filtration.

The Group has announced the conditional agreement to acquire Billi, comprising Billi Australia Pty Ltd, Billi New Zealand Ltd and Billi UK Ltd. Billi is a leading manufacturer and distributor of multifunctional taps. The acquisition is subject to approvals in the three relevant territories.

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Acquisition of Billi

Strix has conditionally acquired Billi Australia Pty Ltd, Billi New Zealand Ltd and Billi UK Ltd (or the combined 'Billi') for a consideration amounting to £38m on a cash and debt free basis and payable in full on completion. The acquisition remains subject to competition authorities' approval in the three territories.

The consideration is inexpensive in our opinion. From management guidance, Billi is expected to deliver proforma revenues of £43.7m and EBITDA of £10.2m in the year to December 2022. On this basis, the FY1 valuation metrics paid amount to 0.87x revenues and 3.725x EBITDA. In addition, we believe Billi also represents a sound strategic fit with the existing constituents of the Strix Group.

The acquisition appears opportunistic. Why? The UK Competition and Markets Authority (CMA) decided that the proposed merger of **Culligan** (owner of several brands, including the Zip HydroTap) and **Waterlogic** (owner of the Billi brand) may have resulted in a substantial lessening of competition in the drinking water solutions (multi-functional taps) market in the UK. As such, the merger was referred for a phase two investigation. The solution suggested by the two parties in early September was the disposal of the Billi multifunctional taps business to mollify the CMA. The purchase of the Billi brand by Strix in the three territories reduces competition concerns and moves the Culligan/Waterlogic merger closer to completion.

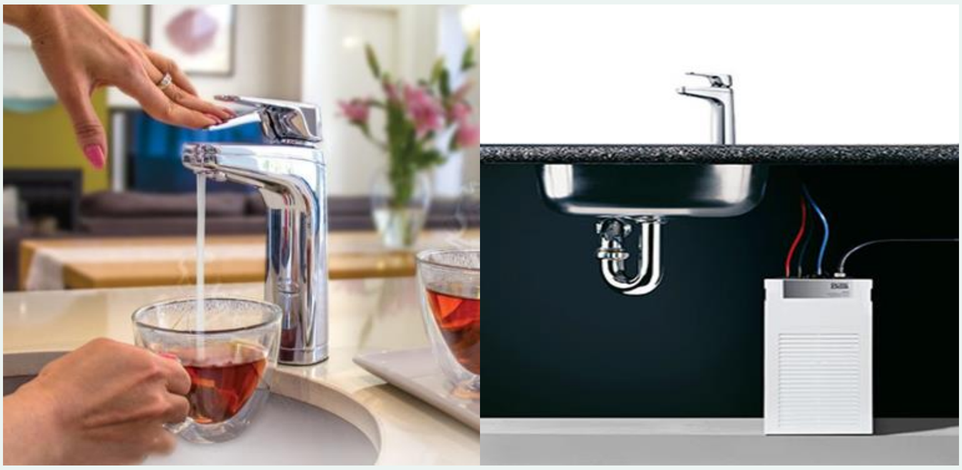
Pre-acquisition, Strix offered a range of countertop appliances, with a gap in under counter water filtration systems, and especially multi-temperature water taps. The purchase of Billi is therefore strategic, increasing the breadth of water dispenser systems within the Group portfolio.

Billi water taps incorporating a filtration system are compact, under the counter units, with only a stylish tap visible above the worktop. They are easy to install in both commercial (office) and home applications, especially where space is at a premium. The move into the domestic market is relatively recent, emphasised by **CAGR rates of 30%,** versus 6% in the commercial and industrial markets.

Typically, the taps (with built in filtration) provide chilled, sparkling, ambient, hot, and extra hot water. Unlike many of its competitors, the Billi system requires **no in-cupboard ventilation** (or noisy cooling fan) and includes a hot water safety mechanism to prevent accidents. The waste heat energy produced during the chilling process is used to pre-heat boiling water, resulting in energy savings.

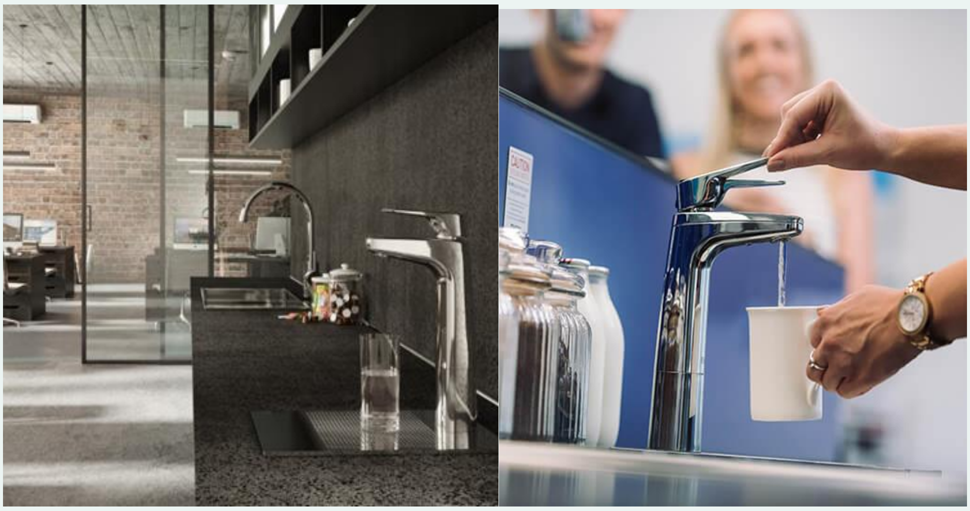
Billi is a plumbed-in product, commanding **premium pricing**. Significantly, not only are consumables such as filters, carbon dioxide canisters and spare parts required but service plans and repairs should result in added value margins for Strix.

Billi taps for domestic use



Source: Waterlogic

Billi taps for commercial spaces



Source: Waterlogic

The solutions that Billi offers are independently certified by Green Tag (international standard v.32), with a **Gold level certification** on the Quadra range. Green tag is one of the world's most trusted ecolabels. The taps benefit from strong structural market trends, based on ESG qualities, including:

- A reduction in single use plastic bottles
- Significant carbon dioxide savings relative to peer products
- The ability to change filters to remove different contaminants from drinking water, by location/country.

The management team of Billi will be retained post-merger, reflecting the healthy historic performance of the business. The senior members will participate in the Group's LTIP to tie them into the Group on a medium-term basis.

We consider it of note that several Director's of Strix participated in the recent placing, purchasing 0.322m shares in the process, at a cost of £0.37m. The participants included the Chairman, CEO, CFO and two of the NEDs.

We have highlighted the low double-digit CAGR in revenues at Billi over the last five years. Looking forward, the drivers of organic growth will centre around:

- New product launches. While we expect the product to continue to command premium pricing, we expect more attractively priced options to be launched, widening the appeal. Sparkling water represents a further product extension which will be examined
- Enter additional geographical markets, by piggybacking on the Group's existing distribution channels – Billi is largely restricted to sales in the UK, Australia, and New Zealand currently
- Domestic systems. Historically, most revenues were derived from commercial and industrial applications. With more people working from home and having used multifunctional taps in the office, demand from residential use continues to improve rapidly
- A cross-selling of Billi and other Strix Group products within the enlarged sales/marketing presence, not least into the commercial sector (Strix's brands are predominantly focused on consumer/residential markets currently)

- Growth in higher margin areas such as consumables, servicing, and spares to reflect the rise in installations

We anticipate that Strix management will follow similar methodologies to previous acquisitions (LAICA and Halo Source) when seeking to improve margins. These will include:

- A move towards Group-wide procurement, where applicable and particularly in consumables
- Greater automation of production. Initially this is likely to increase capex, with a relatively short payback, as headcount reduces
- Manufacture of some components in other Group facilities (China, Italy)
- A greater centralisation of promotional spend.

We highlight our expectation for margins within the next section.

The acquisition will be funded by a combination of a placing of 11.3m shares to raise a gross £13m and an increase in bank borrowing. The revolving credit facility of £80m has been refinanced with a tenure of three years, with options to extend and, a new £49m amortising term loan over the same period. As bank debt falls, the interest rate paid declines, with the overall margin over base not dissimilar to current levels.

Potential financial implications of the acquisition

Management has provided some financial guidance for Billi;

- FY22e proforma revenue and EBITDA of £43.7m and £10.2m, respectively
- Historic 5-year CAGR of revenue growth of low double digits
- Adj. EPS accretion of mid-single digits in the acquisitions' first year as part of the wider Strix Group, followed by 10% accretion in its second full year
- Strong cash generation, averaging 88% of EBITDA
- Post-acquisition debt climbing to a net debt/EBITDA ratio of 1.9x as at end of FY22e, and rapidly declining to 1.4x by the end of FY23e.

On a proforma basis this suggests revenues of c. £160m in FY22e, rising to c.£180m in FY23e. The purchase accelerates the Group's five-year strategic plan, which suggested revenue of £199m and gross profit of £67m. **We think the targets could well be surpassed following the acquisition of Billi during FY24e, with the Group potentially within touching distance of the £67m gross profit in FY23e.**

The degree of EPS accretion in the first two years following completion is encouraging. We think this should result in dividend cover increasing from our pre-acquisition expectation of 1.8x, **thereby providing greater confidence in the above average dividend yield.**

We anticipate further improvements to be made as synergies emerge from the integration of Billi within the water and appliances categories.

The Group raised £13m before expenses from the placing of 11.304m shares at 115p following the announcement of the conditional acquisition of Billi. £10m of the placing proceeds will be used to pay down the term debt, suggesting a net debt at the year end of c£90m or a net debt/EBITA ratio of c.1.9x. The indebtedness includes the £38m consideration, minus the placing proceeds.

However, in view of the Group's strong cash flow generation (including the initial contribution from Billi), we would anticipate debt levels to decline to c.£75m to £80m levels or a net debt/EBITDA ratio of c.1.4x, in line with guidance.

We shall update our financial expectations for the Group once the deal has completed.

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